Case No. S262634

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

ROBERT ZOLLY, RAY MCFADDEN AND STEPHEN CLAYTON

Plaintiffs-Appellants,

v.

CITY OF OAKLAND

Defendant-Respondent

OPENING BRIEF ON THE MERITS

After a Published Decision from the Court of Appeal
First Appellate District Court Case No. A154986
Alameda County Superior Court Case No. RG16821376

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ISSUES PRESENTED FOR REVIEW

This appeal raises three issues regarding whether franchise fees, negotiated between local municipalities and private-sector service providers, are subject to the voter approval requirements for taxes set forth in California Constitution, article XIII C, as amended by Proposition 26 in 2010. As stated in the Petition for Review, the issues presented are:

1. Are franchise fees categorically exempt from the definition of "tax" as "[a] charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property," under California Constitution, article XIII C, section 1, subdivision (e), paragraph (4)[1]?
2. Is *Jacks v. City of Santa Barbara* intended to apply beyond its pass-through surcharge facts and to reach all franchise contracts following the passage of Proposition 26, particularly in light of the significant adverse financial and public health and safety consequences throughout California if *Jacks* is broadly applied?
3. Are franchise fees, negotiated between local governments and private-sector service providers and paid by the franchisees, "imposed" by a local government on taxpayers within the

[1] Article XIII C, section 1, subdivision (e) is referred to herein as, "Article XIII C."

meaning of California Constitution, article XIII C, section 1, subdivision (e), and section 2?

INTRODUCTION

The franchise fees negotiated between Petitioner City of Oakland ("Oakland" or "City of Oakland") and its private waste-hauling and recycling franchisees are not taxes. As contractual consideration for government property interests and the right to do business with Oakland, these franchise fees are categorically exempt from the definition of "tax" under the California Constitution. The contractually-negotiated franchise fees were not "imposed" on Oakland's *ratepayers*, who bear no obligation to pay any part of those franchise fees to the City of Oakland, but were voluntarily assumed by the *franchisees* as a matter of contract.

This Court has not yet ruled on the specific question of whether franchise fees come within the ambit of an imposed "tax" as defined by Proposition 26. The "reasonable relationship to value" test this Court articulated in *Jacks v. City of Santa Barbara* (2017) 3 Cal. 5th 248 (*Jacks*), is not applicable here because *Jacks* expressly did not consider the impact of Proposition 26, its definition of "tax," or the specific categories of charges exempt from that definition – including charges, like franchise fees, for the use or purchase of government property. In addition, *Jacks'* facts are easily distinguished from the case at bar: the mandatory pass-through

surcharge at issue in *Jacks* is materially distinct from the contractually negotiated franchise fees between Oakland and its franchisees.

This legal and factual landscape – that individually negotiated franchise fees owed entirely by the franchisee are not taxes – has not been disturbed by past ballot amendments and is consistent with this Court's prior decisions and the history of franchise and tax law in California. Article XIII C's express exemption of fees for the use or purchase of government property from the definition of "tax" is consistent with the historical treatment of franchise fees as non-taxes and with the fact that neither Proposition 218 nor Proposition 26 made any mention of franchise fees. Thus, the *Zolly* appellate decision adopted an incorrect statutory construction of Article XIII C. The decision also wrongly extended *Jacks* to very different circumstances – Oakland's franchise fees as opposed to Santa Barbara's mandatory pass-through surcharge – to which its holding and reasoning do not apply. The City of Oakland respectfully requests that this Court reverse the Court of Appeal's decision and affirm the Superior Court's judgment and dismissal.

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SUMMARY OF FACTS

I. THE HISTORY OF FRANCHISES AND OF THE RELEVANT VOTER INITIATIVES IN CALIFORNIA

A. California Municipalities Have Granted Franchises to Private Entities to Provide Waste Hauling and Other Services for Over 100 Years

For well over a century, public agencies in California have exercised their constitutional and statutory authority to provide public services through private-entity franchisees. (*Cal. Reduction Co. v. Sanitary Reduction Works of S.F.* (1905) 199 U.S. 306, 317 (San Francisco had the power to award an exclusive franchise for garbage collection to a private company on such terms as it deemed appropriate); see also *City of Glendale v. Marcus Cable Associates, LLC* (2014) 231 Cal.App.4th 1359, 1371 (cable television franchise); *County of Alameda v. Pacific Gas & Electric Co.* (1997) 51 Cal.App.4th 1691, 1694-95 (outlining history of municipal franchises); *Santa Barbara County Taxpayers Assn. v. Bd. of Supervisors* (1989) 209 Cal.App.3d 940, 949 (listing examples of franchises granted by local governments); *City of San Diego v. Southern Cal. Telephone* Co. (1949) 92 Cal.App.2d 793 (franchise to construct and maintain telephone poles, wires, and other telephone equipment); *Ocean Park Pier Amusement Corp. v. Santa Monica* (1940) 40 Cal.App.2d 76 (franchise to maintain and operate public wharf); *City of Oakland v. Great Western Power Co.* (1921)

186 Cal. 570 (franchise for electric service); *City of San Diego v. Kerckhoff* (1920) 49 Cal.App. 473 (railroad franchise).)

The private franchisee typically pays a negotiated franchise fee to the public agency for the right to provide the service and to do business with the municipality. (*Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248, 262 ("a franchise fee is the purchase price of the franchise").) "[H]istorically, franchise fees have not been considered taxes." (*Ibid.*)

B. Voter Initiatives Limit Increases in Local Taxes

Voter amendments limiting taxation began with the passage of Proposition 13 in 1978. Proposition 13 added Article XIII A to the California Constitution, which limits the rate at which taxes based on property values may be increased. (Cal. Const., art. XIII A, §§ 1, 2.) Article XIII A also requires two-thirds voter approval for a local government to impose "special taxes." (*Id.*, § 4.) In 1986, voters enacted Proposition 62, which added Sections 53720 through 53730 to the Government Code. Those sections state that all local taxes, not just "special" local taxes, are subject to voter approval.

In 1996, California voters passed Proposition 218, which added Articles XIII C and XIII D to the California Constitution. Article XIII C incorporates the voter approval requirements of Propositions 13 and 62 by requiring voter approval of any general or special taxes "impose[d], extend[ed], or increase[d]" by any local government. (*Id.*, § 2, subds. (a),

(b), & (d).) Under Article XIII D, property-related assessments, fees, and charges imposed by local agencies for services provided must reflect only the agency's costs of providing the services. (*Id.* art. XIII D, § 6, subd. (b).) Neither Proposition 218 nor its accompanying ballot materials made any mention of franchise fees.

C. Proposition 26 Clarifies the Definition of "Tax"

In 2010, Proposition 26 added a new definition of the word "tax" to Article XIII C of the California Constitution. (Cal. Const., art XIII C, § 1, subd. (e).) Proposition 26 defined "tax" to mean "any levy, charge, or exaction of any kind imposed by a local government."[2] (Cal. Const., art XIII C, § 1, subd. (e).) The new definition also enumerates seven types of charges that are excluded from the definition of "tax." (*Ibid.*) One of these express exclusions from the definition of "tax" is "[a] charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property." (Cal. Const., art XIII C, § 1, subd. (e), par. (4) ("Exemption 4").)

The first three exclusions in Section 1(e) are limited by "the reasonable costs to the local government" or the "reasonable regulatory costs to a local government" in connection with the relevant benefit,

[2] Proposition 26 also added the same definition of "tax" to article XIII A, section 3 of the California Constitution. The only difference between the relevant portions of Article XIII A, section 3 and Article XIII C, section 1 is that the word "state" is substituted for the term "local government."

privilege, service, product, or government function provided. (Cal. Const., art XIII C § 1, subd. (e), pars. (1)-(3).) In contrast, Exemption 4 has no such limitation or qualifying language.

Section 1(e) also prescribes the burden of proof for certain issues that arise in various portions of the definition of "tax." Specifically, it provides that "[t]he local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity." (Cal. Const., art XIII C, § 1, subd. (e).)

II. FACTUAL AND PROCEDURAL BACKGROUND

In February 2012, Oakland initiated a Request for Proposal ("RFP") procurement process for new waste-hauling, mixed materials and organics, and recycling franchise contracts to take effect July 1, 2015. (Compl. ¶1, 1 JA 3; *id.* ¶¶19-20, 1 JA 7.)[3]

After a lengthy and challenging bidding and negotiations process, the Oakland City Council on August 27, 2014 granted Oakland's exclusive recycling services franchise to California Waste Solutions, Inc. ("CWS"),

[3] Citations to "JA" are to the Joint Appendix submitted in the Court of Appeal.

and on September 29, 2014 granted Oakland's exclusive franchise for mixed materials & organics collection services to Waste Management of Alameda County ("WMAC"). Both contracts were contingent on the parties' further negotiation and execution of their respective contracts. (See 1 JA 323-26 ("CWS Ordinance"); 1 JA 139-42 ("WMAC Ordinance").)

The WMAC Ordinance included the following provision regarding the franchise fee at issue here:

> In consideration of the special franchise right granted by the City to Franchisee to transact business, provide services, use the public street and/or other public places, and to operate a public utility for Mixed Materials and Organics collection services, Franchisee shall remit a monthly franchise fee payment to the City, as specified in the Contract. From July 1, 2015, through June 30, 2025, Franchisee shall pay the City a monthly franchise fee of Twenty-Five Million Thirty-Four Thousand Dollars ($25,034,000) per annum, subject to annual adjustment on July 1 each year, as specified in the Contract.

(1 JA 141 at § 6.) Using similar language, the CWS Ordinance set a yearly franchise fee of $3,000,000 subject to annual adjustment. (2 JA 326 at § 5.) The adoption of the WMAC Ordinance reduced Oakland's total franchise fees from their former levels. (Second Amended Complaint ("SAC"), ¶47, 2 JA 284.)

On June 29, 2016, the Zolly Respondents filed a lawsuit challenging the contracts' rates, franchise fees, and AB 939 fee under Proposition 218. (1 JA 1-51.) Three rounds of complaints and demurrers followed; in each

round, Oakland prevailed and the Zolly Respondents were given leave to amend. (1 JA 098-101; 1 JA 271-72; 2 JA 468-80.)

On June 29, 2017, while Oakland's second demurrer was under submission, this Court decided *Jacks*. Oakland brought *Jacks* to the Superior Court's attention. (1 JA 211-270.) On July 12, 2017, the Superior Court sustained Oakland's demurrer in full, with leave to amend. (1 JA 271-72.) Regarding Respondents' franchise fee challenge, the Superior Court agreed with Oakland that "[a] fee paid for government property interest is compensation for the use or purchase of that government asset, rather than compensation for a cost." (*Id*.) The Court further noted, quoting *Jacks*, that "'historically, franchise fees have not been considered taxes, and nothing in Proposition 218 reflects an intention to treat amounts paid in exchange for property interests as taxes.'" (*Id.* (quoting *Jacks*, 3 Cal.5th at 262).)

The Zolly Respondents then filed their Second Amended Complaint ("SAC") seeking a declaration "that any portion of the franchise fee which does not comply with Prop. 218 as codified in the Constitution at Article XIII C is unconstitutional and void," and that such portion "must be refunded to the ratepayers unless approved by vote." (2 JA 286-87.) The Zolly Respondents also amended their challenge to the AB 939 fee, limiting it to its potential future annual increases. (*Id*.) Oakland again demurred. (2 JA 290-459.)

Following extensive oral argument, the Superior Court issued its Order Sustaining Demurrer in Part without Leave to Amend and in Part with Leave to Amend. (2 JA 460-67.) After careful analysis, including a comparison of the fundamental differences between the Oakland franchise fees and the Santa Barbara surcharge in *Jacks*, the Superior Court rejected the Zolly Respondents' challenge to Oakland's franchise fees.

The court ruled that Respondents had not "alleged circumstances sufficient to bring the franchise fees in the instant case within the narrow exception, recognized in *Jacks*, to the general principle, also set forth in *Jacks*, that '[h]istorically, franchise fees have not been considered taxes' and that '[n]othing in Proposition 218 reflects an intent to change the historical characterization of franchise fees, or to limit the authority of government to sell or lease its property and spend the compensation received for whatever purposes it chooses.'" (2 JA 473.) The Superior Court ruled that to hold otherwise "would subject municipalities to potential taxpayer-challenge lawsuits over every franchise agreement into which they enter regardless of whether the fees are imposed on the franchisee rather than the consumer and regardless of how small the amount of the franchise fees negotiated by the parties may be." (*Ibid.*) The Superior Court recognized this would be a "sweeping and burdensome change in the long-established precedents governing taxpayer challenges to franchise agreements negotiated by municipalities" not supported by *Jacks*. (*Ibid.*)

The Superior Court concluded: "This court declines to interpret the holding of the *Jacks* decision beyond its atypical facts." (*Ibid.*)

The Superior Court sustained the demurrer as to the Zolly Respondents' AB 939 fee claim with leave to amend regarding potential future annual increases. Respondents elected not to amend and instead to proceed to the Court of Appeal. The Superior Court entered a Judgment of Dismissal with Prejudice, and the Zolly Respondents appealed. (2 JA 468-80; 2 JA 496.)

The appeal briefing included amicus briefs filed by the League of California Cities in support of Oakland, and the Howard Jarvis Taxpayers Association ("HJTA") in support of the Zolly parties. Oakland filed an Answer to the HJTA amicus brief and a Motion for Judicial Notice of two documents: the Proposition 26 Voter Information Guide, and a Legislative Analyst's Office report regarding tax-related voter approval requirements. (See City of Oakland's February 20, 2020 motion in the Court of Appeal for judicial notice ("MJN"), Exs. 1-2.)[4]

Following oral argument, the Court of Appeal issued a published opinion reversing the Superior Court's order dismissing the franchise fee

[4] The Court of Appeal granted the motion, pursuant to Evidence Code section 452, subdivision (c), in its April 17, 2020 Order Modifying Opinion and Denying Rehearing. Oakland's Motion for Judicial Notice is part of the record transmitted to this Court under Cal. Rule Ct. 8.512(a).

challenge, but affirming the dismissal of Respondents' challenge to the annual AB 939 fee increase.[5] Oakland filed a Petition for Rehearing, noting that the Court of Appeal opinion appeared to have overlooked Oakland's Answer to the HJTA amicus brief and accompanying Motion for Judicial Notice. The Court of Appeal issued an order denying rehearing but granting Oakland's Motion for Judicial Notice. (See Appendix A to June 8, 2020 Petition for Review.)

On June 8, 2020, Oakland filed with this Court a Petition for Review. This Court granted review on August 12, 2020.

STANDARD OF REVIEW

This Court reviews *de novo* decisions concerning the meaning of constitutional provisions, such as California Constitution, article XIII C, and the constitutionality of local government fees. (See *Silicon Valley Taxpayers Assn., Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 448-450; *Greene v. Marin County Flood Control & Water Conservation Dist.* (2010) 49 Cal.4th 277, 287; see also *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 873-74 ("whether impositions are 'taxes' or 'fees' is a question of law for the appellate courts to decide on independent review of the facts").)

[5] The AB 939 ruling is not at issue in this appeal.

This Court likewise reviews *de novo* the legal sufficiency of a complaint on an order sustaining a demurrer. (*T.H. v. Novartis Pharmaceuticals Corp.* (2017) 4 Cal.5th 145, 162.)

LEGAL DISCUSSION

I. Franchise Fees Are Categorically Exempt from the Definition of "Tax" under Article XIII C as Amended by Proposition 26, and Thus Are Not Subject to Any Requirement That They Be Reasonably Related to the Value of the Franchise

This appeal presents the question whether franchise fees are exempt from the definition of "tax" under Article XIII C. That question was expressly reserved in *Jacks*, which did not analyze franchise fees under Proposition 26's amended definition of "tax." The plain language of Article XIII C, as amended by Proposition 26, categorically exempts franchise fees from the definition of "tax" and, thus, voter approval requirements.

A. Charges and Fees Do Not Require Voter Approval and Are Not Limited by Any "Reasonability" Test If They Are Not a "Tax"

The constitutional provisions requiring voter approval before municipal governments can levy certain charges only apply to charges that constitute a "tax." (See *supra* at I.C; Cal. Const., art XIII C, § 1, subd. (e).) A charge that is exempt from the definition of "tax" is therefore *not* a tax and not subject to voter approval. Likewise, a charge that is not a "tax" is exempt from any constitutional requirement that it not exceed the "reasonable cost" of the activity for which the fee is imposed. (*Ibid.*)

B. Article XIII C, Exemption 4's Omission of Any Express Reasonability Requirement Is Clear and Unambiguous, and the *Zolly* Appellate Decision's Contrary Interpretation Flouts Long-Standing Principles of Statutory Construction

As this Court acknowledged in *Jacks*, Article XIII C, Exemption 4 applies to amounts paid in exchange for government property interests, such as franchise fees. (*Jacks*, 3 Cal.5th at 262-63 ("Although Proposition 26 strengthened restrictions on taxation by expansively defining 'tax' as 'any levy, charge, or exaction of any kind imposed by a local government' [citation], it provided an exception for '[a] charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property.'"); see also *Zolly v. City of Oakland* (2020) 47 Cal. App. 5th 73, 86 (*Zolly*) ("Relevant here is the fourth exemption, which applies to 'A charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property.'").)

The language of Exemption 4 is clear and unambiguous: any charge "imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property," is not a "tax" and therefore is exempt from the voter approval requirements of Article XIII C, section 2. (Cal. Const., art. XIII C, § 1, subd. (e), par. (4); see also MJN, Ex. 1, 2014 Legislative Analyst's Office Report at 3, 5.) There is no limitation on the scope of this exemption. In particular, this exemption contains no requirement that the exempted charge must not exceed, or must

be related to, the reasonable cost or value of the property rights conveyed. (*Id.* at 3.)

The language of Exemption 4 directly contrasts with the first three exemptions, which expressly require that the types of charges set forth in those exemptions not exceed the "reasonable costs" or "reasonable regulatory costs" of the service or activity to avoid classification as a "tax." (Cal. Const., art XIII C, § 1, subd. (e), pars. (1)-(3).) Under well-established rules of statutory construction, the express inclusion of a "reasonability" requirement in the first three exemptions underscores the absence of a similar requirement in Exemption 4 and is evidence of voter intent to impose different requirements for different types of charges. (See, e.g., *Howard Jarvis Taxpayers Assn. v. Bay Area Toll Authority* (2020) 51 Cal.App.5th 435, 458-60 (*BATA*) ("If the language is unambiguous and a literal construction would not result in absurd consequences, we presume that the voters intended the meaning on the face of the initiative and the plain meaning governs."), review granted Oct. 14, 2020, No. S263835; *Tuolumne Jobs & Small Business Alliance v. Superior Court* (2014) 59 Cal.4th 1029, 1037 (*Tuolumne Jobs*) (under well-established rules of statutory construction, courts must construe the plain language and avoid interpretations "that lead to absurd results or render words surplusage").) The absence of any qualifying "reasonability" language in Exemption 4 demonstrates that fees for the use or purchase of government property, such

as franchise fees, are *categorically* exempt from the definition of "tax" under California law.

This categorical exemption is consistent with the historical treatment of franchise fees as non-taxes. (See *Jacks*, 3 Cal.5th at 262 ("Historically, franchise fees have not been considered taxes. [Citations.] Nothing in Proposition 218 reflects an intent to change the historical characterization of franchise fees….").) "Prior to the adoption of Proposition 26, 'case law distinguish[ed] between taxes subject to the requirements of article XIII A [or Article XIII C], ... on the one hand, and regulatory and other fees, on the other.'" (*BATA*, 51 Cal.App.5th at 457-458 (quoting *City of San Buenaventura v. United Water Conservation Dist.* (2017) 3 Cal.5th 1191, 1210).)

This Court has recognized that "[i]n general, taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted," and that "[m]ost taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges." (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 874.) Proposition 26 and its amendments to Article XIII C codify these general principles by expressly exempting charges for benefits conferred or privileges granted, or charges imposed in response to a party's voluntary decision to seek other government benefits or privileges – such as the purchase of franchise

property rights – from the definition of "tax." (See Cal. Const., art. XIII C, § 1, subd. (e).)

1. The *Zolly* Appellate Decision Violates Tenets of Statutory Construction by Adding a Reasonability Test to Exemption 4

Notwithstanding Exemption 4's clear omission of any "reasonability" test, the *Zolly* appellate decision erroneously inserted just such a requirement. The Court of Appeal concluded that, "a franchise fee may constitute a tax subject to article XIII C to the extent it is not reasonably related to the value received by the government." (*Zolly*, 47 Cal. App. 5th at 89.) It did so by relying on subdivision (e)'s statement, applicable to all seven of the preceding exemptions, regarding the government's '"burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity.'" (*Id.* at 86-87 (quoting Cal. Const., art. XIII C, § 1, subd. (e)).) The *Zolly* decision interpreted that language to mean that the government must prove the reasonableness of a franchise fee under Exemption 4 even though that exemption imposes no such requirement.

The Court of Appeal's interpretation violates basic tenets of statutory construction. Courts "construe provisions added to the California Constitution pursuant to the same principles governing construction of a statute." (*BATA,* 51 Cal.App.5th at 458-59.) Courts "first examine the language of the initiative as the best indicator of the voters' intent. [Citations.] [They then] give the words of the initiative their ordinary and usual meaning and construe them in the context of the entire scheme of law of which the initiative is a part, so that the whole may be harmonized and given effect.'" (*Id.* (quoting *Schmeer v. City & County of Los Angeles* (2013) 213 Cal. App.4th 1310, 1316-17 (*Schmeer*)) [Citations.].) "If the language is not ambiguous, [courts] presume the voters intended the meaning apparent from that language, and [courts] may not add to the statute or rewrite it to conform to some assumed intent not apparent from that language." (*People v. Superior Court (Pearson)* (2010) 48 Cal.4th 564, 571; see also *Schmeer* at 1316-17 (where language is unambiguous, "we presume that the voters intended the meaning on the face of the initiative and the plain meaning governs") [Citations.].)

Here, the Court of Appeal mistakenly found ambiguity in Exemption 4 where none exists, prompting it to "add to the statute … to conform to some assumed intent not apparent from that language." (*Pearson*, 48 Cal.4th at 571.) Article XIII C, section 1, subdivision (e)'s burden of proof language merely allocates the burden of proving the requirements of each

exemption but does not add any substantive requirements. Accordingly, a local government would have the burden of establishing that a charge is "not a tax" in the first instance (*i.e.*, that it falls under one of the enumerated exemptions), and then that the charge is limited to the "reasonable costs" of an activity or service where an exemption so requires (*i.e.*, the first three exemptions). Nothing in the text suggests, however, that this procedural burden-shifting clause is meant to add substantive requirements to any exemption. The Court of Appeal's interpretation is contrary to the plain language.

The Court of Appeal's interpretation also runs afoul of the canon that "[i]nterpretations that lead to absurd results or render words surplusage are to be avoided" (*Tuolumne Jobs*, 59 Cal.4th at 1037) because it renders the specific "reasonability" language in Exemptions 1 through 3 mere surplusage. (See also *People v. Hudson* (2006) 38 Cal.4th 1002, 1010 ("As we have stressed in the past, interpretations that render statutory terms meaningless as surplusage are to be avoided.").) The express reasonability language in the other exemptions is rendered superfluous if, as the *Zolly* appellate decision incorrectly held, a "reasonability" test can be grafted onto Exemption 4 even though Exemption 4 omits any such language.

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2. *Bay Area Toll Authority* Supports Oakland's Interpretation and Demonstrates That Franchise Fees Are Categorically Exempt

In contrast to and shortly after the *Zolly* decision, the Court of Appeal in *Howard Jarvis Taxpayers Assn. v. Bay Area Toll Authority* (2020) 51 Cal. App. 5th 435 (*BATA*), review granted Oct. 14, 2020, No. S263835, correctly interpreted identical constitutional language to reach the same conclusion that Oakland advocates here. In *BATA*, the court interpreted Article XIII A, section 3, subdivision (b), paragraph (4). The language of that provision mirrors Article XIII C, section 1, subdivision (e), paragraph (4), including an identical burden-shifting provision. (Compare Cal. Const., art XIII C, § 1, subd. (e), par. (4) & subd. (e) last paragraph, *with* Cal. Const., art. XIII A, § 3, subd. (b), par. (4) & subd. (d).) The only difference between the relevant portions of Article XIII A, section 3 and Article XIII C, section 1 is that the word "state" is substituted for the term "local government." The *BATA* court's decision highlights where the *Zolly* court went astray and provides a blueprint for the correct analysis here.[6]

BATA affirmed the trial court's ruling that certain toll charges imposed by the California legislature were by definition *not* taxes because they were exempt as charges "for entrance to or use of state property." (*BATA*, 51 Cal. App. 5th at 458.) The court further held that the burden of

[6] This Court has granted review in *BATA* but deferred further action pending consideration and disposition of a related issue in this case.

proof language in Article XIII A, section 3(d) did not apply to the fourth exemption to add a "reasonable cost" test to fees under that exemption. (*Ibid.* ("[T]he reasonable cost requirement of article XIII A [section 3,] subdivision (d), did not apply to [subdivision (b), paragraph (4)] based on the plain meaning of the language used in section 3. Because the first three exceptions to the general definition of 'tax' contain language limiting the charge to reasonable costs and the fourth and fifth exceptions do not, the [trial] court concluded it could not read the limitation into the latter exceptions.").)

Whereas the *Zolly* appellate decision elevated a generalized and incomplete impression of Proposition 26's purposes over its textual demands, the *BATA* decision remained faithful to the constitutional language and well-established interpretive principles. As the *BATA* court explained, "reading article XIII A, subdivision (d) of section 3 as applicable to all of the subdivision (b) exceptions would render the express reasonableness language in the first three exceptions surplusage," and "'[a] construction making some words surplusage is to be avoided.'" [Citations.] (*BATA*, 51 Cal. App. 5th at 251-2.)

The *BATA* court likewise recognized that the burden of proof language in Article XIII A, section 3, subdivision (d) – identical to Article XIII C, section 1, subdivision (e) – "is a burden shifting provision; it does not impose substantive requirements in addition to those stated" in the

preceding exemptions. (*BATA*, 51 Cal. App. 5th at 252-3.) In doing so, *BATA* pointed out *Zolly*'s failure to "engage in the textual analysis that leads us to conclude subdivision (d) of article XIII A, section 3, does not impose a substantive requirement of reasonableness beyond that stated in subdivision (b) of this section" and noted its "disagree[ment] with *Zolly* on the interpretation of the burden of proof provision." (*Id.* at 253, fn. 18.) The *BATA* court also correctly rejected the notion that courts should disregard the textual, plain language meaning of the provision because it purportedly conflicts with the general purpose of Proposition 26. (*Id.* at 250-1 (rejecting arguments by the *BATA* plaintiffs and Howard Jarvis Taxpayers Association that the trial court's ruling was "'a perversion of Proposition 26'").)

Continuing to use the constitutional language as its compass, the *BATA* court correctly observed that trying to shoehorn a reasonability requirement into Exemption 4 not only impermissibly renders the "reasonable cost" language in the first three exemptions surplusage, but also leads to absurd results when broadly applied to all of the enumerated exemptions. The fifth exemption, for example, excludes "[a] fine, penalty or other monetary charge imposed by the judicial branch of government or a local government, as a result of a violation of law" from the definition of "tax." (Cal. Const., art. XIII C, § 1, subd. (e), par. (5); see also Cal. Const., art. XIII A, § 3, subd. (b), par. (5).) It would be nonsensical to apply a cost-

based reasonability requirement to such fines or penalties because they do not involve any identifiable government cost; they are instead set by the non-confiscatory amounts deemed necessary to deter unlawful conduct. The appellants in *BATA* in fact "conceded in the trial court [that] a reasonable cost limitation makes no sense with respect to the state's … determination of fines and penalties for violations of law." (*BATA*, 51 Cal. App. 5th at 252.)

The *BATA* appellants likewise conceded that a "reasonable cost" test could not be sensibly applied to the part of the fourth exemption concerning the government's "sale or rental of property" because that, too, has no identifiable government cost. (*BATA*, 51 Cal. App. 5th at 252.) The *BATA* court correctly recognized the significance of these distinctions, holding:

> The first three exceptions expressly limit the amount of the charge; the last two do not. Notably, the reasonable costs of the state activities at issue in the first three exceptions can be determined by direct reference to the benefit offered, service provided, or administrative action taken. *There is no similarly self-defining reference point for determining the reasonable cost of allowing entry onto or use of state-owned property*, which might include anything from obvious repairs and upkeep to myriad enhancements of the user's experience. And, as appellants conceded in the trial court, a reasonable costs limitation makes no sense with respect to the state's sale or rental of property or determination of fines and penalties for violations of law.

(*Ibid.* (emphasis added).)

BATA provides a clear roadmap for the textual analysis in which the *Zolly* court should have engaged. Established rules of statutory construction require that "statutes or statutory sections relating to the same subject must be harmonized, both internally and with each other, to the extent possible." (*BATA*, 51 Cal. App. 5th at 243.) [Citations.] The *BATA* decision accomplishes this in a logical fashion to reach the correct conclusion. This Court should engage in the same analysis to reach the same result here.

3. The *Zolly* Appellate Decision Also Incorrectly Conflates "Cost" with "Value"

In addition to improperly grafting a "reasonability" requirement onto Exemption 4 that is absent from the plain language, the *Zolly* appellate decision stretched the text even further to insert the concept of reasonable *value* despite the absence of any reference to "value" in Exemption 4 or elsewhere in Article XIII C. It did so by applying the "reasonable cost" clause in Article XIII C, section 1, subdivision (e)'s burden-shifting provision to franchise fees under Exemption 4, and then incorrectly conflating "cost" with "value."

Article XIII C's first three exemptions refer to fees or charges for services or products provided by local governments, privileges or benefits granted by local governments, or regulatory activities relating to issuing permits, for which there is an associated cost to the government. (Cal. Const., art. XIII C, § 1, subd. (e), pars. (1)-(3).) Exemption 4, by contrast,

refers to the use or purchase of a government property interest for which there is no associated government cost. (Cal. Const., art. XIII C, § 1, subd. (e), par. (4).)

Despite acknowledging this important textual distinction between Exemptions 1 through 3 and Exemption 4, the Court of Appeal used subdivision (e)'s burden of proof clause to require that fees for the use or purchase of government property must be reasonably related to the *value* of the interest conveyed. (See *Zolly*, 47 Cal.App.5th at 86-87.) But subdivision (e) does not mention "value" at all; it merely establishes evidentiary standards where a fee is based on "cost." (See Cal. Const., art. XIII C, § 1, subd. (e); see also *BATA*, 51 Cal. App. 5th at 252.) By interpreting the term "reasonable cost" to encompass the entirely separate concept of "value," the *Zolly* court impermissibly "rewr[ote]" the language "to conform to some assumed intent not apparent from that language." (*Pearson*, 48 Cal.4th at 571.) This constituted two errors: (1) importing the concept of "reasonable cost" from the procedural burden of proof clause to substantively modify Exemption 4; and then (2) equating "cost" with "value" in an effort to make sense of the exemption as modified.

Zolly's improper conflation of "cost" and "value" conflicts with this Court's decision in *Jacks*, which made clear that franchise fees should not be limited by "costs." (E.g., *Jacks*, 3 Cal.5th at 268 ("a fee paid for an interest in government property is compensation for the use or purchase of

a government *asset* rather than compensation for a cost") (emphasis in original).)[7] And, of course, "cost" and value" mean very different things. Cost relates to the expenditure required to provide a service, product, or benefit, whereas value relates to what a party is willing to pay and what the market will bear for a particular good or asset.[8]

Had voters intended to limit charges under Exemption 4 for the use or purchase of government property to their reasonable *value*, they would have included such language expressly. As it turns out, the voters included neither "cost" nor "value" in Exemption 4. Rather, the voters categorically exempted any "charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property" from the definition of "tax." (Cal. Const., art. XIII C, § 1, subd. (e), par.

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[7] See also *id.* at 269 ("Unlike the cost of providing a government improvement or program, which may be calculated based on the expense of the personnel and materials used to perform the service or regulation, the value of property may vary greatly, depending on market forces and negotiations."); *id.* at 272-73 ("in contrast to fees imposed for the purpose of recouping the costs of government services or programs, which are limited to the reasonable costs of the services or programs, franchise fees are not based on the costs incurred in affording a utility access to rights-of-way").

[8] Merriam-Webster defines "cost" as "the amount or equivalent paid or charged for something." (Merriam-Webster.com Dictionary, Merriam-Webster, <https://www.merriam-webster.com/dictionary/cost> (as of Oct. 15, 2020.) It separately defines "value" as "the monetary worth of something," or "a fair return or equivalent in goods, services, or money for something exchanged." (Merriam-Webster.com Dictionary, Merriam-Webster, <https://www.merriam-webster.com/dictionary/value> (as of Oct. 15, 2020.)

(4).) This language is dispositive. Any further qualification would rewrite what the voters enacted.

C. Even Assuming, Arguendo, That Article XIII C Is Ambiguous, Key Evidence of Voter Intent Shows That Franchise Fees Are Exempt and Are Not Taxes

Even if Article XIII C were ambiguous, as *Zolly* incorrectly held, the ensuing analysis of Proposition 26's ballot initiative and other legislative history materials would dictate the same result: franchise fees are categorically exempt from Article XIII C's definition of "tax" and thus are not subject to voter approval requirements.

After deeming Article XIII C ambiguous, the *Zolly* decision relied on high-level, generalized statements of intent over more specific expressions of intent to treat franchise fees in a manner consistent with their historical characterization as "non-taxes." (See *Zolly*, 47 Cal.App.5th at 87-88 (finding that the Proposition 26 ballot initiative history shows a general intent "to expand the definition of what constituted a 'tax' for purposes of article XIII C" and that "[n]owhere does the [Legislative Analyst's] analysis identify any narrowing of the definition of a state or local tax") (citing Voter Info. Guide, Gen. Elec. (Nov. 2, 2010) analysis of Prop. 26 by the Legislative Analyst, p. 57)).) To the extent that any of these sources need to be consulted in the first place, given the clarity of Exemption 4's plain language, the more specific expressions of intent should control the analysis.

The same materials on which the Court of Appeal relied contain numerous specific statements that clearly identify the types of fees and charges Proposition 26 was intended to impact. Franchise fees are *not* on this list. The Legislative Analyst's statement that "other fees and charges 'Are Not Affected'" by Proposition 26 (MJN Ex. 2, Voter Info. Guide, Gen. Elec., p. 58) thus provides further confirmation that the measure was not intended to govern franchise fees.

Proposition 26 focuses on improper regulatory fees and did not identify franchise fees as a type of charge Proposition 26 was intended to affect. (See also *Schmeer,* 213 Cal.App.4th at 1326 (Proposition 26 was passed "in an effort to curb the perceived problem of a proliferation of *regulatory fees* imposed by the state") (emphasis added).) The initiative's Findings and Declarations of Purpose show that Proposition 26 was specifically intended to address the disguising of new taxes as *regulatory* fees: "Fees couched as 'regulatory' but which exceed the reasonable costs of actual regulation or are simply imposed to raise revenue for a new program and are not part of any licensing or permitting program are actually taxes and should be subject to the limitations applicable to the imposition of taxes." (See Ballot Pamp., Gen. Elec. (Nov. 2, 2010) Prop. 26 "Findings and Declarations of Purpose," § 1(e), <https://repository.uchastings.edu/ca_ballot_props/1305/>.)

Consistent with this stated purpose, in the Voter Guide's "Background" section, the Legislative Analyst explained that "fees and charges…typically pay for a particular service or program benefitting individuals or businesses," and described the "three broad categories of fees and charges": "user fees," "regulatory fees," and "property charges." (See MJN Ex. 2, Voter Information Guide for 2010 General Election, <https://repository.uchastings.edu/ca_ballot_props/1335/>, Analysis by Leg. Analyst at 56.) The Legislative Analyst described those categories as follows:

> - User fees — such as state park entrance fees and garbage fees, where the user pays for the cost of a specific service or program.
>
> - Regulatory fees — such as fees on restaurants to pay for health inspections and fees on the purchase of beverage containers to support recycling programs. Regulatory fees pay for programs that place requirements on the activities of businesses or people to achieve particular public goals or help offset the public or environmental impact of certain activities.
>
> - Property charges — such as charges imposed on property developers to improve roads leading to new subdivisions and assessments that pay for improvements and services that benefit the property owner.

(See MJN Ex. 2, Voter Information Guide for 2010 General Election, https://repository.uchastings.edu/ca_ballot_props/1335, Analysis by Leg. Analyst at 56 (emphasis added).)

"Franchise fees" are notably absent from this list. Moreover, because franchise fees represent bargained-for contract consideration for the purchase of government property, they do not fall within the definition of a "user fee," "regulatory fee," or "property charge." A franchise fee is *not* charged (1) "for the cost of a specific service or program" (user fee); (2) to "pay for programs that place requirements on the activities of businesses or people to achieve particular public goals or help offset the public or environmental impact of certain activities" (regulatory fee); or (3) to "pay for improvements and services that benefit [a] property owner" (property charge). (MJN Ex. 2, Analysis by Leg. Analyst at 56; see also *Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal.4th 205, 217 (defining user fees); *Apartment Assn. of Los Angeles County, Inc. v. City of Los Angeles* (2001) 24 Cal.4th 830, 843, fn. 6 (defining regulatory fees) (citing *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 876 (quoting *Pennell v. City of San Jose* (1986) 42 Cal.3d 365, 375)).)

In short, a franchise fee is not imposed to "pay for a particular service or program benefitting individuals or businesses." (MJN Ex. 2, Analysis by Leg. Analyst at 56.) Rather, it is a contractually bargained-for payment between the government and the private-sector franchisee for the purchase of valuable franchise rights. (See, e.g., *Santa Barbara County Taxpayer Assn. v. Bd. of Supervisors* (1989) 209 Cal.App.3d 940, 949.)

The Legislative Analyst further highlighted "disagreements regarding regulatory fees" as a key motivating factor underlying Proposition 26, noting that "[o]ver the years, there has been disagreement regarding the difference between *regulatory fees* and taxes…." (MJN Ex. 2, Analysis by Leg. Analyst at 57 (emphasis added); *id.* at 58 ("[g]enerally, the types of fees and charges that would become taxes under the measure [Proposition 26] are ones that government imposes to address health, environmental, or other societal or economic concerns").) This background, too, makes no mention of franchise fees as a concern underlying Proposition 26.

The arguments for and against Proposition 26 were likewise focused on regulatory fees. (*See* MJN Ex. 2, Arguments at 60-61 (proponents argued Proposition 26 would protect "legitimate fees such as those to clean up environmental or ocean damage, fund necessary consumer regulations, or punish wrongdoing," while opponents argued it was driven by "big oil, tobacco, and alcohol companies" wishing to avoid environmental and consumer protection fees, and would "harm local public safety and health").) These arguments have nothing to do with franchise fees.

Indeed, *nowhere* does the Proposition 26 Voter Guide manifest any intent to impose limitations on franchise fees. That the ballot is silent regarding franchise fees is "indicative of an absence of intent to affect that subject." (*Citizens Assn. of Sunset Beach v. Orange County Local Agency*

Formation Com. (2012) 209 Cal.App.4th 1182, 1197, fn. 19 (ballot arguments' "total silence on a subject can indeed be indicative of an absence of intent to affect that subject") (citing *Penziner v. West Am. Finance Co.* (1937) 10 Cal.2d 160, 178 (finding it "quite significant that in the argument in support of the amendment sent to all voters … there is not one word indicating an intent to repeal the usury law…. It is quite unlikely that if the [L]egislature in drafting, and the [P]eople in adopting, the constitutional provision had intended it to repeal the usury law, such intent would not have been clearly expressed")); see also *Cal. Cannabis Coalition v. City of Upland* (2017) 3 Cal.5th 924, 940-41 (rejecting city's broad interpretation of "local government" under Proposition 218 where interpretation was not supported by plain language or ballot materials).)

A 2014 Legislative Analyst's Office's report entitled, "A Look at Voter-Approval Requirements for Local Taxes" ("2014 LAO Report"), further rebuts any notion that Proposition 26 was intended to restrict franchise fees. (See MJN Ex. 1.) The report "was developed to provide context for discussions about the state's voter-approval requirements." (*Id.* at 1.) In asking, "Is the Charge a Tax?," the Legislative Analyst's Office explained:

> Some types of local government charges are not considered taxes and, therefore, are not subject to voter approval. In general, a local government levy, charge, or exaction is a tax and subject to voter approval unless it meets at least one of seven exemptions

> defined in the State Constitution….Some charges are *categorically exempt*: fines and penalties for violating the law, *entrance charges and charges for use of government property*, local property development charges, and property assessments and property-related fees imposed in accordance with Proposition 218….

(*Id.* at 3 (emphasis added); *id.* at 5, Fig. 3 (flow chart showing a "charge for use of government property" categorically is "not a tax and voter approval is not required").) The Legislative Analyst thus confirmed what is apparent from Proposition 26's language: charges for the "use of local government property," or the "purchase…of local government property," under Article XIII C's Exemption 4 – such as franchise fees – are categorically exempt from voter approval requirements and are not subject to any "reasonability" test.

The generalized assertions of the broad overall purpose behind Proposition 26 on which the *Zolly* court relied cannot overcome these specific expressions of voter intent *not* to disturb decades-long precedent distinguishing franchise fees from the types of fees and charges that may constitute taxes. The *BATA* court considered the same general assertions that Proposition 26 was intended to "'expand the definition of taxes'" and "'close perceived loopholes,'" yet correctly recognized that the fourth exemption does not expressly or impliedly include any reasonability test. The same analysis and result should prevail here.

D. *Jacks* Did Not Address Proposition 26

Because the *Jacks* surcharge predated Proposition 26, *Jacks* did not analyze whether the Santa Barbara surcharge was or was not a "tax" under Article XIII C's amended definition and exemptions. As this Court expressly stated: "We are concerned only with the validity of the surcharge under Proposition 218. Proposition 26's exception from its definition of 'tax' with respect to local government property is not before us." (*Jacks*, *supra*, 3 Cal.5th at 263, fn. 6.) Setting aside the important factual distinctions discussed in the next section, the *Zolly* appellate decision overlooked this significant legal distinction in ruling that *Jacks* dictates the outcome here.

Whatever the outcome of this case might have been before the passage of Proposition 26, this Court is now presented with the question whether the *Jacks* opinion's "reasonable relationship to value" language may apply to franchise fees *after* the passage of Proposition 26, which categorically exempts franchise fees from the definition of "tax." As shown above, the plain language of Article XIII C and the Proposition 26 ballot initiative history make clear that a broad application of *Jacks* to the franchise fees in dispute here is inconsistent with Article XIII C and the historical treatment of franchise fees as non-taxes. (See *Jacks, supra*, 3 Cal.5th at 269-70.)

II. The *Zolly* Appellate Decision Incorrectly Extended *Jacks* Beyond Its Limited Holding

Even if Proposition 26's categorical exemption of franchise fees from the definition of "tax" were not dispositive of this case, Oakland's franchise fees still would not qualify as "taxes" under *Jacks*. *Jacks* involved a surcharge imposed directly on, and paid exclusively by, ratepayers – which is *not* the case for Oakland's franchise fees. The *Zolly* appellate decision expanded *Jacks* beyond its mandatory pass-through surcharge facts and incorrectly extended it to circumstances where neither its holding nor its rationale applies.

Jacks was decided on narrow factual grounds that are absent here and make clear why the Oakland franchise fees categorically are not a tax. The Court's analysis was driven by the particular features of the Santa Barbara surcharge – most importantly that the *ratepayers*, and not the utility (Southern California Edison (SCE)), bore the obligation to pay the surcharge. The *Jacks* parties stipulated that the 1% surcharge at issue would be collected by SCE and remitted to the city, but that it would be paid *by ratepayers* in the form of an itemized surcharge on their utility bills. (See *Jacks*, *supra*, 3 Cal. 5th at 254-56 & 270-71.)[9] This Court thus found that

[9] Among other things, the parties stipulated in *Jacks* (1) that SCE had filed a request with the CPUC to allow it "to bill and collect from its customers…a 1.0% electric franchise surcharge to be remitted to the City by SCE *as a pass-through fee*, pursuant to SCE's new franchise agreement

"SCE was not willing to assume the burden of paying the surcharge, and that both parties to the agreement understood that *the charge would be collected from ratepayers*." (*Id.* at 271 ("the City and SCE agreed that SCE would impose the surcharge on customers and remit the revenues to the City") (emphasis added).)

There are no such facts here. Nothing in Oakland's franchise agreements or implementing ordinances reflects any agreement or understanding that the franchise fees would be paid *by ratepayers* as opposed to the franchisees themselves as the contractual consideration they voluntarily assumed. As the Superior Court correctly ruled, the *Jacks* fee is materially different from Oakland's franchise fees because it was not a fee paid *by SCE* to Santa Barbara for franchise rights, but a "direct 'pass-through'… to the ratepayers" that the franchisee and city *agreed* would be paid by the ratepayers, not the utility. (2 JA 473-4.) The *Jacks* surcharge was "(a) itemized as a 'separate charge' on consumer electricity bills; (b) mandatorily collected by the franchisee, SCE; and (c) remitted by SCE, dollar for dollar, to the City of Santa Barbara, pursuant to the agreement with the city." (2 JA 473.)

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with the City," and (2) that pursuant to Santa Barbara's implementing ordinance, "all PERSONS in the CITY receiving electricity from SCE *are obligated to pay* the 1% [surcharge]." (See *Jacks*, *supra*, 3 Cal.5th at 277.)

Here, in contrast, the waste hauling and recycling franchisees contractually agreed to pay the franchise fees and remitted those payments directly to Oakland, with no agreed-upon pass-through directly to ratepayers and no mandatory imposition of those fees on ratepayers. That some portion of those franchise fees might be included as one cost factor in setting rates does not bring them within the framework of *Jacks*, where the surcharge was imposed directly on ratepayers as their obligation alone, not the utility's. The Court made this abundantly clear in *Jacks* itself: "Valid fees do not become taxes simply because their cost is passed on to the ratepayers." (See *Jacks*, *supra*, 3 Cal.5th at 271.)

The mandatory pass-through surcharge in *Jacks* differs materially from the voluntarily-negotiated franchise fees in this case. The "reasonable relationship to value" test this Court applied to the *Jacks* surcharge does not and should not apply where the franchise fee burden is voluntarily assumed *by the franchisee* and not imposed on the ratepayer. Limiting *Jacks* to its narrow, direct pass-through facts preserves the long-held principle that franchise fees are not taxes, but bargained-for contract consideration in exchange for valuable property rights.[10]

[10] Applying *Jacks* broadly to all franchise fees also would have far-reaching practical impacts on cities and counties throughout California that utilize the contractual franchise fees they receive to help fund essential public services and programs. Moreover, subjecting all current and future California franchise contracts to a nebulous and impracticable "reasonable

III. Oakland's Franchise Fees Are Not a Tax Under Article XIII C Because They Are Not "Imposed"

A. Oakland's Franchise Fees Are Not "Imposed" Because They Are Voluntarily Assumed by the Waste Haulers as Contract Consideration for Franchise Rights

Oakland's franchise fees are not taxes for another reason, separate and apart from the exemption of franchise fees under Article XIII C, Exemption 4: they are not "imposed" by the City of Oakland. A fee or charge constitutes a "tax" if and only if it is "imposed by a local government" in the first instance. (Cal. Const., art. XIII C, § 1, subd. (e) (defining "tax" as "any levy, charge, or exaction of any kind *imposed by a local government*, except the following…") (emphasis added).) The voter approval requirements the Zolly Respondents invoke in this matter are similarly limited to "imposed" taxes, providing that "[n]o local government may *impose*…any general tax" or "may *impose*…any special tax" without voter approval. (Cal. Const., art. XIII C, § 2, subds. (b) & (d) (emphasis added).) If a fee is not imposed, it is, by definition, not a tax.

The voluntary, contractual nature of franchise fees is inimical to the concept of an "imposed" charge as that term has been defined under California law. "A franchise is a negotiated contract between a private

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relationship to value" test would inject increased cost and uncertainty into an already complicated government contracting process, making it more difficult for cities and counties to provide essential public services to their residents without interruption.

enterprise and a governmental entity for the long-term possession of land." (*Santa Barbara County Taxpayer Assn. v. Bd. of Supervisors* (1989) 209 Cal.App.3d 940, 949.) Accordingly, franchise fees are the contract consideration paid in exchange for those valuable franchise rights, including the right to do business with the municipality. (See *Pacific Tel. & Tel. Co. v. City of Los Angeles* (1955) 44 Cal. 2d 272, 283; see also *City of Santa Cruz v. Pacific Gas & Electric Co.* (2000) 82 Cal. App. 4th 1167, 1171.)

This Court has confirmed that franchise fees are contract consideration that a franchisee *voluntarily* pays for a franchise. In *Contra Costa County. v. American Toll Bridge Co.* (1937) 10 Cal.2d 359, 363, for instance, this Court explained:

> [T]he public body making the grant can prescribe terms and conditions in the granting and for the acceptance of a franchise. [Citations.] One of these conditions may be the requirement of payment of money, the amount of which may be fixed without regard to the cost of supervision or inspection. [Citation.] And when so required *this condition becomes a part of the contract which the grantee has voluntarily assumed.* [Citation.]

(Emphasis added.) The Court's prior decision in *Tulare County. v. City of Dinuba* (1922) 188 Cal. 664, similarly concluded that franchise fees are "purely a matter of contract," noting: "[I]t is a matter of option with the applicant whether he will accept the franchise on those terms. His

obligation to pay *is not imposed by law but by his acceptance of the franchise*." (*Id.* at 670 (emphasis added).)

As voluntary contract consideration, franchise fees by definition cannot be "imposed" so as to come within the constitutional definition of a "tax." "The phrase 'to impose' is generally defined to mean to establish or apply by authority or force, as in 'to impose a tax.'" (*Ponderosa Homes, Inc. v. City of San Ramon* (1994) 23 Cal.App.4th 1761, 1770; see also *Cal. Cannabis Coalition v. Upland* (2017) 3 Cal.5th 924, 944 ("to impose" means "to establish" or to "enact").) But franchise fees are not established by authority or force. Rather, they are freely negotiated and voluntarily assumed by franchisees competing for the privilege to do business with the local government entity, and to operate an exclusive, long-term franchise on and within city or county property.

The record establishes that Oakland's franchise fees were voluntary contract consideration assumed by the private waste-hauling and recycling franchisees. The franchise agreements and implementing ordinances make clear that Oakland's franchise fees are consideration for franchise rights. (See 2 JA 326, 331, 344, & 351.) The ordinance authorizing the WMAC franchise, for example, makes clear that the franchise fees are charged:

> [i]n consideration of the special franchise right granted by the City to Franchisee to transact business, provide services, use the public street and/or other public

> places, and to operate a public utility for Mixed Materials and Organic collection services.

(2 JA 331; see also 2 JA 326 (similar).)

Oakland's RFP and negotiations process demonstrates that WMAC and CWS actively competed for the exclusive franchise rights being offered by Oakland, and thus voluntarily assumed the obligation to pay the franchise fees negotiated as consideration for the exclusive franchises granted. (See 2 JA 277-82; 1 JA 6-35.) These facts are inconsistent with the notion of an "imposed tax" under California law because, as this Court has held, "[m]ost taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges." (See *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 874; see also *Jacks, supra*, 3 Cal. 5th at 268 ("The aspect of the transaction that distinguishes the charge from a tax is the receipt of value in exchange for the payment.").)

This Court in *Jacks* implicitly recognized that a fee voluntarily assumed is not a tax "imposed" on ratepayers. (*Jacks, supra*, 3 Cal.5th at 270.) Santa Barbara argued in *Jacks* that "the surcharge is not a tax imposed on ratepayers because it is a burden SCE voluntarily assumed." (*Ibid.*) This Court rejected that argument on its facts, finding that the terms of the franchise agreement "belie the contention that SCE assumed a burden to pay the surcharge." (*Ibid*.) But this Court did not reject the underlying

premise that if SCE *had* voluntarily assumed that burden, it would not constitute a tax.

That premise applies here. Unlike SCE in *Jacks*, Oakland's franchisees, WMAC and CWS, *did* voluntarily assume the obligation to pay the franchise fees to Oakland. Because here, the franchisees and only the franchisees are contractually obligated to pay the franchise fees to Oakland, the franchise fees are not "imposed" and thus are not a tax.

B. That the Franchise Fees May Be One Cost Factor in Setting the Franchisees' Rates Does Not Convert the Fees Into a Tax "Imposed" on Ratepayers

Because Oakland's franchise fees are contractually agreed consideration between Oakland and the waste-hauling and recycling franchisees, they are not "imposed" even though those fees may be used as one cost factor among many in setting rates to customers. This Court confirmed in *Jacks* that "[v]alid fees do not become taxes simply because their cost is passed on to the ratepayers." (*Jacks*, *supra*, 3 Cal.5th at 271.) Consistent with that principle, the Superior Court correctly held that "[t]he possibility that some portion of the franchise fee may later be used by the franchisee as a cost factor in setting rates to its customers is not material to the legality of the franchise fees where, as here, there is no direct pass-through of the fees to the customers." (2 JA 473.)

The *Zolly* appellate decision nonetheless held that *Jacks* "implicitly rejected" this argument because the Santa Barbara surcharge's "contractual

formation did not automatically exempt the charge from being defined as a 'tax.'" (*Zolly, supra,* 47 Cal.App.5th at 88-89.) But *Jacks* focused on the fact that SCE expressly *refused* to pay the 1% surcharge. Thus, even though the *Jacks* surcharge was established "[p]ursuant to an agreement," that agreement made clear that the surcharge would be passed through to the ratepayers and paid directly *by them*, not SCE. (*Jacks, supra,* 3 Cal. 5th at 254, 270-73.) SCE was responsible only for collecting and remitting those funds to Santa Barbara – it bore no legal obligation to pay any part of that charge. "In sum, the City and SCE agreed that SCE would impose the surcharge on customers and remit the revenues to the City." (*Id.* at 271 (emphasis added).)

Oakland's franchise fees stand in contrast to the surcharge in *Jacks* because there was no similar agreement to impose those fees directly on ratepayers. As the Superior Court found:

> [T]he franchise fees were negotiated between the respective contracting parties, *with the contractual obligation to pay those fees resting directly upon the franchisees, rather than as part of negotiated pass-through to the taxpayers*. [Citations.] Indeed, the franchisees remain responsible to pay the franchise fees to the City regardless of whether or not their customers utilize their waste collection and recycling services. Here, the agreement between the City and WMAC acknowledges that consumers may decline collection services at the consumer's discretion…. Hence, unlike the stipulated facts in *Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248, *the franchise fees here are not being imposed by the City on its residents.*

(2 JA 487-8 (emphasis added).) Unlike in *Jacks*, therefore, the franchisees here assumed the sole legal obligation to pay the franchise fees.[11]

By overlooking this key distinction, the *Zolly* decision departs from established authorities that distinguish between the legal versus economic incidence of a fee in determining whether it is "imposed" and, thus, whether it can be deemed, or challenged by ratepayers, as a "tax." Those authorities show that a fee or tax is imposed only on the party that bears the *legal* incidence (*i.e.*, obligation) of the fee or tax – as distinguished from a party that bears the economic incidence of the fee or tax that is passed on as part of a price, rate, or other charge. (See *Western States Bankcard Assn. v. City & County of S.F.* (1977) 19 Cal.3d 208, 217 (absent "mandatory pass-on provisions," banks' joint venture was itself responsible for tax and did not enjoy bank's tax immunity, even if the cost would ultimately be borne by member banks); *Occidental Life Ins. Co. of Cal. v. State Bd. of Equalization* (1982) 135 Cal.App.3d 845, 847 (legal incidence of sales tax

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[11] In *Jacks*, for instance, SCE was permitted to terminate its agreement with Santa Barbara "if the PUC did not agree to the inclusion of the surcharge on customers' bills." (*Jacks*, *supra*, 3 Cal.5th at 270.) From that, this Court concluded that "it does not appear that SCE assumed any burden to pay the surcharge from its assets." (*Ibid.*)

In contrast, the contracts between Oakland and its franchisees WMAC and CWS contain no such contingency clause allowing the franchisees to terminate the contracts if they are unable to recover the cost of the franchise fees (or any part thereof) through their customers' rates. WMAC and CWS are legally obligated to pay the franchise fees *in full*, no matter whether their customers pay their bills.

is imposed on retailer, not consumer, notwithstanding retailer's "passing on" of tax to consumer).)

This distinction is also relevant here because only those bearing the legal incidence of a purported tax have standing to challenge it. "To challenge the validity of a tax or other government levy, a plaintiff must be directly obligated to pay it." (*Chiatello v. City & County of S.F.* (2010) 189 Cal.App.4th 865, 872 (retail customers lack taxpayer standing because sales tax is imposed on retailers, even though ultimately paid by the customers).) The *Jacks* ratepayers bore the legal incidence of the 1% surcharge because SCE refused to pay it from its own assets and agreed only to pass it on directly to the ratepayers. Here, by contrast, the franchisees alone – not the ratepayers – bore the legal incidence of the franchise fees.

This indisputable fact means that the Zolly parties do not have standing to challenge the franchise fees in this case even if they could be considered a "tax."[12] The Second District Court of Appeal applied this rule to analogous facts in *County Inmate Telephone Services Cases* (2020) 48 Cal.App.5th 354 (*County Inmate*), review den. There, the plaintiff inmates challenged certain privately-negotiated commissions as allegedly improper

[12] Although a standing defense was not explicitly raised below, it may be considered by this Court. (See, e.g., *Common Cause v. Bd. of Supervisors* (1989) 49 Cal.3d 432, 438-39 ("contentions based on a lack of standing involve jurisdictional challenges and may be raised at any time in the proceeding").)

taxes. The commissions were paid by telecommunications providers to various counties for exclusive contract rights but were allegedly passed on to the inmates through increased costs for telephone services. The court rejected the plaintiffs' challenge because they did not bear the legal incidence of the commissions, and thus lacked standing to challenge them:

> Plaintiffs paid nothing to the counties, and they had no legal responsibility to pay anything to the counties. Simply asserting that they effectively or indirectly 'paid the illegal tax' does not make it true. Plaintiffs may have paid exorbitant charges to the *telephone provider*, but they did not make any payment to the *county* and they had no legal obligation to do so.

(*County Inmate*, 48 Cal.App.5th at 359-61 (emphasis in original).)

The same reasoning applies here, where ratepayers do not pay the franchise fees to Oakland and have no legal obligation to do so. Oakland residents who contract for WMAC's and CWS's waste hauling and recycling services pay the charged rates *to those franchisees*. In fact, ratepayers are not required to utilize the franchisees' waste hauling or recycling services if they instead choose to self-haul their waste. (See 2 JA 487-8 (noting that the franchise agreements "acknowledge[] that consumers may decline collection services at the consumer's discretion" if they "obtain[] a permit to self-haul waste" in compliance with city regulation).)

In short, the franchise fees in this case were not "imposed" by Oakland on anyone – much less on ratepayers. The franchisees voluntarily assumed the franchise fees, and only the franchisees have the legal

obligation to pay those fees to Oakland. In contrast, ratepayers have *no* obligation to pay the franchise fees or any portion thereof to Oakland. That the franchisees calculated their rates by reference to a bundle of cost factors that included the franchise fees "is not material to the legality of the franchise fees" and does not convert them into a tax subject to voter approval. (2 JA 488; see also *Jacks, supra*, 3 Cal.5th at 271.)

As a result, whether viewed as a lack of imposition or, as in *County Inmate*, a lack of ratepayer standing to challenge the franchise contracts, the fact that the ratepayers do not bear the legal incidence of the franchise fees is another independent reason why the Court of Appeal's decision should be reversed.

CONCLUSION

For the foregoing reasons, Petitioner City of Oakland respectfully requests that the Court reverse the decision of the Court of Appeal and affirm the Superior Court's judgment of dismissal.

Dated: October 16, 2020

Respectfully submitted,

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Pursuant to Rule of Court 8.504(d)(1), the undersigned hereby certifies that the computer program used to generate this brief indicates that it includes 11,038 words, including footnotes and excluding the parts identified in Rule 8.504(d)(3).

Dated: October 16, 2020

/s/ *Cedric Chao*
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Case No. S262634

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

ROBERT ZOLLY, RAY MCFADDEN AND STEPHEN CLAYTON

Plaintiffs-Appellants,

v.

CITY OF OAKLAND

Defendant-Respondent

CERTIFICATE OF SERVICE

After a Published Decision from the Court of Appeal
First Appellate District Court Case No. A154986
Alameda County Superior Court Case No. RG16821376

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